M E M O R A N D U M

TO: Members of the Commission

FROM: Linda Foy and Jerry Sapiro

DATE: July 9, 2004 Meeting

RE: Agenda Item II.F: Further Revised Rule 1-500: Agreements Restricting a Member's Practice

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In connection with the Commission's continuing consideration of Rule 1-500, we set forth below

(1) Current Rule 1-500;

(2) ABA Model Rule 5.6;

(3) Proposed revision based upon review and discussion at the Commission's 5/7/04 meeting

(4) Redline against Current Rule

The proposed revision reflects the majority vote of the Commission members

(i) to remove subparagraph 1-500(B) ("A member shall not be a party to or participate in offering or making an agreement which precludes the reporting of a violation of these rules") from the current Rule, along with the drafters' recommendation to re-locate the content of subparagraph (B) in a separate Rule of Professional Conduct 1-130, to be entitled Agreements Precluding the Reporting of a Violation. As proposed, Rule 1-130 would follow

Rule 1-110. Disciplinary Authority of the State Bar and

Rule 1-120. Assisting, soliciting, or Inducing Violations

(ii) to conform the format and substance of the rule as closely as possible to ABA Model Rule 5.6;

(iii) to retain references to "member" pending subsequent, systematic discussion of proposed replacement of "member" with "lawyer" in specific rules or portions of rules;

(iv) to retain the concept that the Rule's prohibition on agreements restricting the practice of law should extend to agreements "in connection with the settlement of a lawsuit or otherwise."

I. Current Rule of Professional Conduct 1-500

Rule 1-500. Agreements Restricting a Member's Practice

(A) A member shall not be a party to or participate in offering or making an agreement, whether in connection with the settlement of a lawsuit or otherwise, if the agreement restricts the right of a member to practice law, except that this rule shall not prohibit such an agreement which:

(1) Is a part of an employment, shareholders', or partnership agreement among members provided the restrictive agreement does not survive the termination of the employment, shareholder, or partnership relationship; or

(2) Requires payments to a member upon the member's retirement from the practice of law; or

(3) Is authorized by Business and professions Code sections 6092.5 subdivision (i), or 6093.

(B) A member shall not be a party to or participate in offering or making an agreement which precludes the reporting of a violation of these rules.

Discussion:

Paragraph (A) makes it clear that the practice, in connection with settlement agreements, of proposing that a member refrain from representing other clients in similar litigation, is prohibited. Neither counsel may demand or suggest such provisions nor may opposing counsel accede or agree to such provisions.

Paragraph (A) permits a restrictive covenant in a law corporation, partnership, or employment agreement. The law corporation shareholder, partner, or associate may agree not to have a separate practice during the existence of the relationship; however, upon termination of the relationship (whether voluntary or involuntary), the member is free to practice law without any contractual restriction except in the case of retirement from the active practice of law. (Amended by order of Supreme Court, operative September 14, 1992.)

II. ABA Model Rule 5.6

Rule 5.6 Restrictions on Right to Practice

A lawyer shall not participate in offering or making:

(a) a partnership, shareholders, operating, employment, or other similar type of agreement that restricts the right of a lawyer to practice after termination of the relationship, except an agreement concerning benefits upon retirement; or

(b) an agreement in which a restriction on the lawyer's right to practice is part of the settlement of a client controversy.

Comment:
[1] An agreement restricting the right of lawyers to practice after leaving a firm not only limits their professional autonomy but also limits the freedom of clients to choose a lawyer. Paragraph (a) prohibits such agreements except for restrictions incident to provisions concerning retirement benefits for service with the firm.
[2] Paragraph (b) prohibits a lawyer from agreeing not to represent other persons in connection with settling a claim on behalf of a client.
[3] This Rule does not apply to prohibit restrictions that may be included in the terms of the sale of a law practice pursuant to Rule 1.17

III. Proposed New Rule 1-500

Rule 1-500. Restrictions on a Member's Right to Practice

A member shall not offer or enter into:

(A) a partnership, shareholder, operating, employment or other similar type of agreement that restricts the right of a member to practice law after termination of the relationship; or

(B) any other agreement, whether in connection with the settlement of a lawsuit or otherwise, that restricts a member's right to practice law.

Notwithstanding subparagraph (A) of this rule or unless otherwise proscribed by law, a member may offer or enter into an agreement that provides for forfeiture of compensation to be paid after termination of membership in or employment by a law firm if the member competes with that law firm after such termination, provided that:

1. The member's eligibility for receipt of such compensation is conditioned on minimum age and length of service requirements; and

2. The compensation will be paid from future firm revenues, not from compensation already earned by the member, the member's share in the equity of the firm, the member's share of the firm's net profits, or the member's vested interest in a retirement plan.

Discussion:

Subparagraph (A) does not prohibit a restrictive covenant in a law corporation, partnership or employment agreement that provides that a member who is a law corporation shareholder, partner or associate shall not have a separate practice during the existence of the relationship; however, upon termination of the relationship (whether voluntary or involuntary), the member is free to practice law without any contractual restriction except in the case of retirement from the active practice of law or as further noted below.

The exception for certain agreements relating to compensation to be paid after termination of membership in or employment by a law firm does not apply to all agreements in connection with any withdrawal from a firm but is intended to apply to *bona fide* retirement agreements. Authorities interpreting the analogous "retirement benefits" exception under Model Rule 5.6 have identified the factors enumerated in subparagraphs 1 and 2 as essential attributes of such retirement agreements. *See, e.g.*, *Neuman v. Akman*, 715 A.2d at 136-37 (D.C. Dist. 1998) (lifetime payments to former partners who satisfy age and tenure requirements qualify as true retirement benefits); *Donnelly v. Brown, Winick, Graves, Gross, Baskerville, Schoenebaum & Walker, P.L.C.*, supra, 599 N.W.2d at 682 (Iowa 1999) (policy of distributing benefits after "ten years of service and sixty years of age or twenty-five years of service ... clearly qualifies as a retirement plan"); *Miller v. Foulston, Siefkin, Powers & Eberhardt*, supra, 246 Kan. at 458, 790 P.2d 404 (payments made to former partners who satisfy age, longevity or disability requirements "[f]it squarely within the exception of [the ethics rule]"). Significantly, these

authorities have applied the retirement benefits exception to circumstances involving less than full retirement, thereby implicitly rejecting the notion that public policy requires the complete cessation of practice in order to qualify under the exception to rule. *See also Neuman v. Atkman*, 715 A.2d at 136 (retirement benefits come "entirely from firm profits that post-date the withdrawal of the partner"); Virginia State Bar Standing Committee on Legal Ethics Opn. No. 880 (1987) (distinguishing "compensation already earned" from benefits funded "by the employer or partnership or third parties" that qualify under retirement benefits exception); *Anderson v. Aspelmeier, Fisch, Power, Warner & Engberg*, 461 N.W.2d 598, 601- 02 (Iowa 1990) (payments of former partner's equity holdings do not qualify as retirement benefit); *Pettingell v. Morrison, Mahoney & Miller*, 426 Mass. 253, 257-58, 687 N.E.2d 1237 (1997) (distribution of acquired capital does not constitute retirement benefit); *Cohen v. Lord, Day & Lord*, supra, 75 N.Y.2d at 100, 551 N.Y.S.2d 157, 550 N.E.2d 410 (retirement benefits exception does not authorize forfeiture of partner's uncollected share of net profits).

While Rule 1-500 bars agreements restricting an attorney's right to practice law after withdrawal from a law firm, the Supreme Court has held that the Rule does not *per se* prohibit a law partnership agreement that provides for reasonable payment by a withdrawing partner who continues to practice law in competition with his or her former partners in a specified geographical area after withdrawal. *See Howard v. Babcock*, 6 Cal. 4th 409, 425 (1994). The Court's rationale for permitting such agreements is that "an agreement that assesses a reasonable cost against a partner who chooses to compete with his or her former partners does not restrict the practice of law. Rather, it attaches an economic consequence to a departing partner's unrestricted choice to pursue a particular kind of practice." *Id.* at 419. However, the toll exacted must not be so high that it unreasonably restricts the practice of law. *Id.* at 419, 425. *See* depublished decision, *Howard v. Babcock*, 47 Cal. Rptr. 650 (1995). *See also Haight, Brown & Bonesteel v. Sup. Ct.*, 234 Cal. App. 3d 963, 969-71 (1991) (Rule 1-500 does not prohibit agreement providing for withdrawing partner to compensate former partners if withdrawing partner chooses to represent clients previously represented by firm); *Schlessinger v. Rosenfeld, Meyer & Susman*, 40 Cal. App. 4th 1096 (1995) (partnership agreement reducing withdrawing partner's share of fees if such partner competes with law firm not considered unlawful toll on competition). *But see Champion v. Superior Court*, 201 Cal. App. 3rd 777(1988) (forfeiture of future fees for cases taken by withdrawn partner unconscionable under former Rule 2-107).

In addition, Rule 1-500 does not prohibit agreements otherwise authorized by Business and Professions Code sections 6092.5(i) or 6093 (governing agreements regarding conditions of practice, entered into between respondents and disciplinary agency in lieu of disciplinary proceedings or in connection with probation) or in connection with the sale of a law practice as authorized by Business & Professions Code sections 16602 *et seq*. (governing agreements not to compete in connection with dissolution of or dissociation from partnership); *see also* Los Angeles Bar Ass'n Form. Opn. 480 (1995) (partnership agreement that does not survive analysis under Business and Professions Code section 16600 *et seq.* may violate Rule 1-500).

IV. Drafters' Revisions and Recommendation

A. Re-location of current subsection (B). The drafters have implemented the Commission's vote to re-locate current subsection (B) of Rule 1-500 elsewhere in the rules. The drafters recommend the creation of Rule 1-130 [as ultimately re-numbered], entitled Agreements Precluding the Reporting of a Violation. As proposed, Rule 1-130 would follow

Rule 1-110. Disciplinary Authority of the State Bar; and

Rule 1-120. Assisting, soliciting, or Inducing Violations

An alternative would be to add the text of subsection (B) to existing Rule 1-120 and to re-title Rule 1-120 "Assisting, Soliciting or Inducing Violation and Reporting Professional Conduct." In either case, the discussion section for the newly-located rule should reference Business and Professions Code 6090.5, which precludes a member from agreeing or seeking an agreement not to report professional misconduct, to withdraw a disciplinary complaint or to seal the record of a civil action for professional misconduct.

B. Conform format and substance to MR 5.6. The majority of the Commission voted to conform the revised Rule 1-500 as closely as possible to Model Rule 5.6, as reflected in the current revision.

D. Retain prohibition on agreements that restrict a member's right to practice law "whether in connection with the settlement of a lawsuit or otherwise." The Commission earlier voted to retain this language, which is broader than the prohibition in Model Rule 5.6 (barring agreements in which a restriction on the right to practice "is part of the settlement of a client controversy").

-----Original Message-----
From: Jerome Sapiro, Jr. [mailto:JSapiro@sapirolaw.com]
Sent: Tuesday, May 04, 2004 5:13 PM
To: Sondheim, Harry B.
Cc: Tuft, Mark L.; Vapnek, Paul W.; Betzner, Karen; Foy, Linda Quan; George, Edward P.; JoElla J. Julien; Lamport, Stanley; Martinez, Raul; Melchior, Kurt W.; Peck, Ellen R.; Ruvolo, Hon. Ignazio J.; Voogd, Anthony; Kevin E. Mohr; Difuntorum, Randall; McCurdy, Lauren; Hollins, Audrey
Subject: Rule 1-500

Dear Harry:

This will respond to the issue you raised regarding whether Rule 1-500(A) should include an exception to the effect of "unless otherwise required by law." I recommend that we not add such an exception for several reasons.

First, I assume you made the suggestion because of the decision in *Chan v. Intuit, Inc.*, 218 F.R.D. 659 (N.D. Cal. 2003). If an order that counsel not practice in a given area is entered as a result of a discovery dispute or otherwise, over the objection of the affected attorney, the attorney against whom such an order is entered will not have violated Rule 1-500(A). The attorney will not have entered into an agreement but, instead, has to comply with a court order. The attorney may have been ordered not to engage in a particular type of practice, but the rule prohibits offering, accepting, or entering into such an agreement. Involuntarily being subjected to such an order is not the same as agreeing one. A lawyer who is the subject of such an order will not have violated the rule.

Conversely, in *Chan*, the order was not entered involuntarily. The parties drafted a protective order and agreed that the protective order was necessary to protect confidential information. They agreed that the attorneys for plaintiffs who had access to confidential information should be barred from patenting for a party not only during the pendency of the pending litigation but also for two years after its conclusion. They only disagreed on the scope of two paragraphs of the order defining what "patenting" would mean in the context of the agreed order. In my judgment, the plaintiffs' attorneys thereby violated Rule 1-500(A).

Should we create an exception that would permit them to do so? In my opinion, the answer is "no." The reason for my opinion is twofold. First, as a matter of public policy, attorneys should not be permitted to enter into such a protective order voluntarily. Not only the plaintiffs in *Chan* but also all other potential clients who want to hire attorneys to prosecute patents now find that the number of attorneys available to do so has been reduced. Although one could argue that there are already more than enough intellectual property attorneys, that argument misses the point. By reducing the competition among lawyers, we reduce the access members of the public would otherwise have to competent counsel. Expanding such access is one of the purposes of Rule 1-500(A). Reducing the availability of attorneys is the opposite of what the rule is intended to promote.

Second, in my opinion the rule should have been called to the attention of the court. Instead of acquiescing in the order, counsel for the plaintiffs in *Chan* should have pointed to Rule 1-500 as a rule with which they are obliged to comply. They should have argued the public policy of not depriving the public of the availability of counsel of choice and the policy of the bar of this State to assure the availability of counsel. Instead, they agreed to limit the availability of counsel and conceded that the protective order was necessary in order to protect confidential information.

The latter is incorrect, in any event. Attorneys are given access to confidential information all the time in many different kinds of litigation, but that has not in my experience been an excuse for limiting the

availability of counsel in a substantive area of the law. Instead, counsel have been ordered not to utilize the confidential information except for the purpose of prosecuting or defending the particular case. By acquiescing in the defense argument in *Chan*, the attorneys for the plaintiffs abandoned the Rule of Professional Conduct and failed to call to the attention of the court the public policy issues that underlie the rule. If the court had been presented with the public policy issues and the duty of compliance with Rule of Professional Conduct 1-500(A), it might well have decided not to enter a protective order as requested by the defense. By abandoning the rule and not calling the public policy issues to the attention of the court, plaintiffs' attorneys may have induced the court to act contrary to the public interest. The arguments should at least have been brought to the court's attention. After all, every member of the bar of the United States District Court for the Northern District of California is required to be familiar with and comply with the standards of professional conduct required of members of the California State Bar. L.R. 11-4(a)(1).

I agree with your point that, sometimes, lawyers have to give up the opportunities for themselves in order to represent a client properly. However, giving the lawyers more business opportunities is not the policy underlying Rule 1-500(A). Instead, the public policy is twofold. First, restricting the right of lawyers to practice restricts the ability of the public to find counsel. Second, restricting the ability of lawyers to practice limits the freedom of clients to representation by counsel of choice. We would certainly not be arguing about whether, in order to settle a case, attorneys for plaintiffs in *Chan* could stipulate to entry of judgment permanently enjoining them from prosecuting any other case against *Intuit*. I see no reason why, as a matter of principle, prosecution of a patent in competition with *Intuit* should be any different from the litigation context.

With best regards,

Jerry